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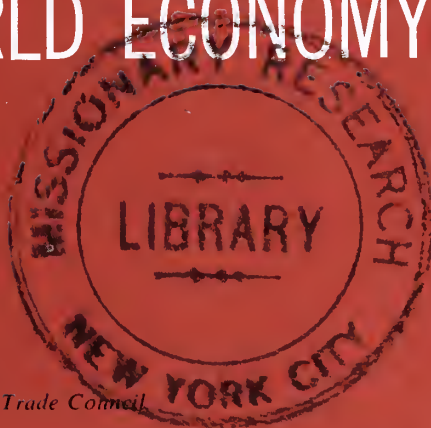


JAPAN

IN THE WORLD ECONOMY

*Lecture to a Class
on Japanese Civilization
at Dartmouth College*

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When Professor Edwin Reischauer attempted to assess Japan's future some ten years ago, he viewed the problems facing Japan's economy with some pessimism. "The future of the Japanese economy is almost as unpredictable as the outside pressures on Japan," he wrote in 1953.¹

Summarizing the many difficult obstacles facing postwar Japan—population pressure, shortage of arable land, heavy dependence on imports, war-time destruction of Japan's foreign trade, the loss of her prewar markets and sources of raw materials in China, Manchuria and Korea as well as Southeast Asia, and so forth—, Reischauer concluded: "Under these circumstances, the economic future of Japan is at best doubtful."²

Professor Reischauer's pessimism was shared by nearly all informed observers, both Western and Japanese, ten years ago. The fact that the forecast turned out to be wrong should remind us that, in the words of a prominent British economist who is also an expert on Japan, "economists, like the rest of mankind, possess only a feeble capacity for prediction."³

¹ Edwin O. Reischauer, *Japan Past and Present*, (Second Edition, Charles E. Tuttle Co., Tokyo, 1953), p. 261.

² *Ibid.*, p. 263.

³ G. C. Allen, "Japan's Economic Prospects," *The World Today* (Royal Institute of International Affairs, London), October 1963, p. 439.

What is Japan's economic situation today, ten years later? By the mid-1950's industrial production and per capita income had been restored to the prewar level. Since then, industrial output has trebled and national income in real terms has more than doubled. Japan's average growth rate of more than 9 percent a year has been the highest of any modern industrial economy.

This forward surge has lifted Japan to the front ranks of the world's industrial powers. In manufacturing output Japan now stands in fifth place after the United States, the Soviet Union, Great Britain and West Germany—ahead, you will observe, of France, the aspirations of General De Gaulle notwithstanding.

In steel production, a basic index of industrialization and today's status symbol of developing countries, Japan is ahead of West Germany in third place. In electric power generation and cement output it also ranks third or a close fourth. For several years now Japan has been the world's largest shipbuilder. In ball bearings, cameras, radios and television sets it ranks second. In machine tools and pharmaceuticals it ranks fourth.

Japan's dynamic growth since its recovery from the ashes of World War II is one of the truly significant events of our time. Though it has received far less publicity, it is far more impressive than the vaunted "German Miracle," because Japan has not only overcome wartime destruction and dislocation but has simultaneously completed the transformation from an underdeveloped country to a modern industrial economy. It is, I submit, Japan which has achieved the "Great Leap Forward" in Asia.

But—and this is the really interesting question—how and why did this come about? How were the many difficult obstacles facing the new Japan, so aptly analyzed by Professor Reischauer, successfully overcome?

What about the population pressure, for example, the critical problem facing most developing countries which tends to defeat our aid programs? The slackening in the rate of population growth already foreseen by Reischauer in 1953 has become an actuality. As a result, Japan's population has tended to level off and is likely to reach stability at about 100 million people. Successful population control, indeed, is one of several features which distinguish Japan from developing countries throughout the world.

Of course, even 100 million people are a lot of people in a country the size of California, only 16 percent of whose total land area can be cultivated. Indeed, Japan still has a higher proportion of people to arable land than any other country in the world. The secret of Japan's success has been intensive cultivation of its limited land resources by means of advanced techniques, fertilizers, etc. plus its extensive fisheries. Even so, of course, Japan depends on imports for much of its food as well as its raw materials.

And that, I think, brings us to the real key to the success of Japan's "Great Leap Forward"—the tremendous expansion of her foreign trade. In the ten years since 1953 Japan's exports have risen fivefold—from \$1 billion to \$5 billion. This has made possible a simultaneous threefold growth in imports, from \$2 billion to \$6 billion. Without this expansion of foreign trade, Japan's amazing economic growth in the last ten years would have been inconceivable.

IV Of course, this merely explains at best *how* Japan's comeback has been accomplished. The *why* is more difficult, but also more interesting, and will take a little longer.

What were the main factors that made possible Japan's rapid emergence as a modern industrial society? I shall not dwell on the historical roots of modern Japan, which laid the basis for industrialization, because you are all familiar with them after two months of lectures. I shall rather single out four or five features which, I believe, are significant to an understanding of Japan's dynamic growth since the end of World War II.

One vital element lies in Japan's trained, skilled and industrious labor force. Universal education has given Japan one of the highest literacy rates in the world. Japan understood long ago that the road to modernization lies in education; that schools came before steel mills as the *true* status symbols of a modern industrial society—a lesson which many developing countries have yet to grasp.

A second critical factor has been Japan's high rate of savings and investment. Total domestic investment has averaged nearly a third of gross national product over the entire postwar period, climbing as high as 42 percent in 1961. (By comparison, gross private investment in the United States amounted to 9 percent of GNP.) This heavy investment in new plants and new equipment has made possible rising labor productivity. This, in turn, led to major gains in wages and real income,

while keeping Japan's production costs competitive in world markets.

A third important feature has been Japan's successful combination of public planning and private initiative. The Government's role in fostering economic expansion is exemplified in the "income doubling" plan for the decade of the Sixties. Prepared in close cooperation with all sectors of production, it sets forth a series of goals for private industry and public investment, with the aim of doubling national income and output by 1970. The program is running well ahead of schedule, so that the goals may be reached as early as 1967 or 1968.

A fourth key factor lies in the monetary and fiscal policies pursued by Japan's Government. In 12 of the last 13 years the Government has actually cut tax rates to offset the rise in tax receipts that comes with larger incomes, thus maintaining incentives for work. At the same time, the Bank of Japan has followed a strong policy of monetary expansion, except in periods of acute balance-of-payments difficulty.⁴ Simultaneously, Japanese industry has made a strenuous effort to catch up with Western technology. (Over the past 12 years nearly 2,000 patent licensing and technical assistance agreements have been negotiated with foreign companies, about two-thirds of them American.)

Finally, of course, there was an important external element in Japan's achievement. First there was the U.S. Occupation with its liberalizing influence on Japan's economic and political life. Later, American policy was successfully directed at re-integrating Japan into the expanding network of world trade. In our concern—some might say obsession—with the failure of the U.S. aid program, we might pause long enough to recall that here in Japan (as also in Europe) *it worked*.

V Japan's rapid postwar growth has brought a peaceful revolution to the country. Rising living standards have created a consumption-oriented middle class, with changing habits of diet and dress, greater leisure time, and a growing appetite for luxuries. In short, the Affluent Society, made in Japan!

The signs of this new prosperity are readily apparent, as I had occasion to observe in Tokyo, Osaka, Kyoto and Northern Kyushu less than a year ago. Urban construction is proceeding at a frantic pace; modern department stores are jammed with shoppers; city streets and highways

⁴ Japan's fiscal and monetary policy led the London *Economist* to recommend it as a model for Great Britain. (*Consider Japan*, by correspondents of *The Economist*, Gerald Duckworth & Co., Ltd., London, 1963.)

are clogged with compact Japanese cars, trucks and motorcycles; and new gasoline stations seem to mushroom everywhere.

This diffusion of material well-being is not limited to the cities. The chain reaction that started with the U.S.-sponsored land reform has meant a new life for the one-third of Japan's people who remain on the farm. With tenancy reduced to less than 10 percent and the heavy debt burden lifted, farmers now have both the means and the incentive to raise output. Meanwhile, the steady shift of surplus labor from farm to factory has given a further boost to rural incomes by eliminating rural underemployment.

Thus, Japan's independent farmers and her wage-earners are now a major prop to the economy. They provide the mass market needed to sustain low-cost, high-volume production.

VI Obviously, Japan's affluent society—like our own—is not Utopia. For every problem that has been solved, a new one has arisen. But the problems are at a higher level of economic development. (As the lady said after a long session at the United Nations, “I am still confused, but now I am confused at a much higher level!”)

What are Japan's current problems? I shall have time to list only a few. Of the domestic problems, the one that struck me most on my trip to Japan last year is what economists might term, in the dismal language of the dismal science, “the problem of infrastructural disequilibrium.”

Translated into English, it means the lagging state of public sector development. Japan is handicapped by inadequate roads, overtaxed rail and port facilities, and major gaps in municipal services. Catching up with these public needs is made more difficult by the rapid gains in automobile ownership and continued spread of suburbs in all directions. (Does any of this sound familiar?)

The dilemma of Japan's dual economy has existed for many years. On the one hand, large-scale modern industry; on the other, small stores and workshops and tiny farms. Lagging productivity and low income in the latter have been a chronic problem. Now, with labor shortages pushing wages upward, the problem is becoming more critical for the small-scale sector of the economy.

A more recent problem is that of mounting consumer prices. Reflecting the added costs of food, services and distribution, consumer

prices have climbed 3 percent in 1960, 5 percent in 1961, 6 percent in 1962 and 8 percent last year. This is evidence of labor scarcity. The scramble for workers is forcing wages up, particularly in the traditionally low-wage sectors of the economy—retailing and services, small workshops and farming.

Another problem, as some see it, pertains to the other sector of the dual economy, the large-scale modern industry. The *Zaibatsu* are no longer, but the problem of economic concentration and oligopoly remains. This is not conducive to competition—in Japan as in the United States—and the concentration of economic power has obvious social and political implications as well.

VII Finally—and this leads us from Japan's domestic to its foreign economic problems—a controversy has long been raging among Japanese economists as to whether the country's amazing growth rate has not been *excessive*. (This will *not* sound familiar to American ears.)

What the critics of rapid growth have in mind are the recurrent balance-of-payments problems caused by the domestic investment and consumption boom and the resulting high rate of imports. They also point to rising wages and mounting consumer prices as the heavy price paid for rapid growth. Can exports, they ask, keep pace with imports? And should not the "overheated" economy be restrained?

In actual fact, it frequently has been. (This is a bit like Mark Twain on how to stop smoking: "There's nothing to it. I've done it many times.") From time to time, the Japanese Government has had to apply the brakes of credit restraint to over-rapid business expansion in order to keep the country's international payments in balance.

The tight-money policy pursued so effectively by the Bank of Japan in 1961-62 was dictated by a widening trade gap and the resulting sharp decline in foreign exchange reserves. Mounting inflationary pressures since then have recently prompted a renewal of monetary restraints.

The crucial foreign economic problem facing Japan today is the same as ten years ago—whether exports can keep pace with imports. Devoid of most natural resources, Japan—like Britain—must trade in order to live. The problem is especially acute today because Japan has embarked on a program of trade liberalization, which is likely to stimulate consumer good imports.

In the past ten years Japan's exports *have* risen almost as fast as her

imports. What is more significant, her newer exports (items like transistor radios, micro-TV, electrical goods, cameras, binoculars and motor-cycles) have risen even more rapidly than her traditional exports (textiles, toys, chinaware, etc.). This augurs well for the future, since Japan's industrial structure is rapidly shifting from the traditional labor-intensive industries to the new, sophisticated, more capital-intensive industries.

The geographic structure of Japan's foreign trade is important in this context. Deprived of her prewar markets and sources of raw materials in China, Manchuria and Korea, Japan has turned to the United States. Over the past decade the U.S. has furnished about one-third of Japan's imports and currently purchases about 30 percent of her exports. No other nation accounts for more than 5 percent of Japan's trade, although Asia as a whole ranks equal in importance to the United States. The remaining third is widely distributed, including Europe and Latin America.

VIII

This brings us to the final portion of today's talk—Japan's role in the world economy. Clearly, as the only advanced industrial country in Asia, and as the fifth largest manufacturing nation in the world, Japan's future economic orientation is a matter of critical importance in world politics. Moscow and Peking are watching events in Tokyo as closely as do Washington and London—and let us not forget Paris!

Japan is keenly aware of her close economic ties with the United States—much more so than we are of our ties with her. (And that despite the fact that Japan today is our biggest export market after Canada and that in the last ten years our trade with her has yielded us an export surplus of some \$3 billion.) The question today is whether the West can truly and fully accept within its ranks the first modern industrial society that is non-white and non-Occidental. If the West cannot, the East can and will. And the East is more likely to be Peking than Moscow.

To be sure, Japan has long been a member of the United Nations, the International Bank and Monetary Fund and the GATT, and she is about to join the Organization for Economic Cooperation and Development (hitherto purely a "white man's club.") But discrimination against Japan still persists, especially in Europe, and not solely on grounds of commercial competition.

This discrimination is unquestionably the main reason for the lagging trade between Europe and Japan. While the U.S. brought \$6.24 of Japanese imports per capita in 1961, the European Economic Community received only 95 cents worth. The EEC countries have consistently exported far more to Japan than they have imported.

Europe's discriminatory import restrictions against Japan are outworn practices, not in keeping with the economic or political realities of today's world and with Europe's stake in a strong and prosperous free world community. In the absence of European discrimination against Japan, the volume of two-way trade between them could be expanded substantially, to the advantage of all concerned.

But, in addition to Japan's important trade with the United States and with Europe, a large and growing trading area must of necessity be in Asia. This is true for reasons of both geography and economics. As the leading industrial country in the Far East, Japan can supply her developing neighbors with the industrial equipment needed for their development and obtain in return the primary commodities required by her industries.

This brings us to the controversial question of Japan's trade with Mainland China. Before the war, China was Japan's largest export market. Since then trade has dwindled to a trickle. In 1963 Japan's trade with Red China and the Soviet Union combined amounted to less than 4 percent of her total trade. Japan's position is that trade with Mainland China is important to her economy and should be developed.

Since the United States is the only Western country that maintains a complete embargo on trade with Red China, and since Great Britain, West Germany and France all trade with her, we can scarcely expect Japan to remain in total isolation from a country which is the fountain-head of her culture. In fact, it may well be that the gradual development of trade between Japan and China will result in introducing new contacts, new thoughts and new opportunities behind the Bamboo Curtain.

IX In conclusion, remembering that "economists, like the rest of mankind, possess only a feeble capacity for prediction,"

I shall refrain from forecasts about Japan's economic future. Instead, I would like to leave with you two thoughts about Japan's possible role in world economics and politics.

One pertains to the East-West conflict and the other to what has been termed the North-South problem—the relations between the industrial-

ized nations of North America and Europe, on the one hand, and the emerging countries of Asia, Africa, and Latin America, on the other.

In the East-West relationship, the recent lessening of international tensions has increased the importance of smaller nations. Paradoxically, both Washington and Moscow have discovered that this new and complex world could be a mixed blessing—as have Paris and Peking! At any rate, it now appears that the role that Japan could play in the world has gained somewhat in importance.

In the North-South conflict—which may some day overshadow in importance the East-West power struggle to which we have become accustomed—Japan certainly can play an important and constructive role. As a country which has performed the transformation to a modern industrial society within this century, Japan can serve as a link between the aspirations of the emerging countries and the interests of the advanced industrial nations, because it has a clear understanding of both.

The gap between the rich and the poor countries has been getting larger, not smaller, in recent years. To the contrasts of wealth and poverty is added the explosive dynamite of race and color differences. Japan, as the first modern industrial society that is non-white and non-Occidental, can perform an important role in helping to conciliate this dangerous conflict.

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